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No. 85-727

In the Supreme Court of the United States

OCTOBER TERM, 1985

MISSOURI FARMERS ASSOCIATION, INC., PETITIONER

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

MEMORANDUM FOR THE UNITED STATES IN OPPOSITION

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Petitioner contends that the court of appeals erred in holding that Farmers Home Administration (FmHA) regulations, rather than state commercial law applicable to private lenders, govern the validity of a release of FmHA liens.

1. Between February 1978 and April 1979, the FmHA made several loans totalling $70,630.00 to Edward Stoops to assist him in operating his farm in Chariton County, Missouri. As part of the loan agreements, Edward and Barbara Stoops executed financing statements creating a security interest in their crops and farm equipment. In 1979 and 1980, the Stoops' financial position worsened, and they eventually defaulted on their loans, leaving an outstanding balance of $67,926.00 at the time of the trial. During the period from March 1, 1980, through July 1, 1980, Edward Stoops sold crops covered by the financing statements to

petitioner for $32,014.90, but did not pay any of the proceeds to the FmHA. Pet. App. 1-2.

2. The United States then filed this suit against petitioner to recover damages for the conversion of property in which it held a security interest. Petitioner in turn brought a third-party claim for indemnification against Stoops. Pet. App. 1. After a trial, the district court entered judgment in favor of the United States for $32,014.90 and denied petitioner's claim for indemnification (*id.* at 1-5). The court rejected petitioner's contentions that the FmHA had lost any enforceable security interest in the Stoops' crops by authorizing the sales to petitioner (*id.* at 2-3). Petitioner claimed that Missouri law provides that a secured creditor's consent to a sale of collateral terminates the creditor's security interest.[1] The government relied on FmHA regulations that provide that the FmHA retains its security interest in collateral sold with its consent, unless the proceeds are used for certain specified purposes not involved here.[2]

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[1]Missouri's codification of the Uniform Commercial Code provides that "a security interest continues in collateral notwithstanding sale * * * by the debtor unless his action was authorized by the secured party." Mo. Ann. Stat. § 400.9-306(2) (Vernon 1965).

[2]7 C.F.R. 1962.17(b) provides in part that "[FmHA] County Supervisors may release normal income security when the property has been sold or exchanged for its present market value and the proceeds are used for one or more of the following purposes." These "purposes" include payment of debts owed to the FmHA, payment of debts to creditors whose liens are superior to the FmHA's, and payment of income taxes. It is not disputed that the proceeds here were not used for any of the legitimate purposes specified in the regulation. In addition, 7 C.F.R. 1962.18(b) provides:

> The borrower must account for all security * * *. When borrowers sell security, the sale will be made subject to the FmHA lien. The property and proceeds will remain subject to the lien until the lien is released or the sale is approved by the County Supervisor and the proceeds are used for one or more purposes stated in 1962.17.

The court of appeals initially entered a brief per curiam opinion (Pet. App. 12-14) "affirm[ing] the judgment on the basis of the trial court's memorandum and order" (*id.* at 13). The court subsequently granted rehearing and entered a second opinion reaffirming its earlier decision (*id.* at 17-19). The court concluded that "[a]doption of state law in this case would conflict with the federal interests present in the FmHA loan program" (*id.* at 19). Therefore, it ruled that the federal law governing the case, under *United States* v. *Kimbell Foods, Inc.*, 440 U.S. 715 (1979), was that embodied in the federal regulations.

3. The court of appeals' decision is correct, does not conflict with any decision of another court of appeals, and presents no issue warranting review by this Court.

Petitioner contends (Pet. 6-8) that the court of appeals' decision is inconsistent with *United States* v. *Kimbell Foods, supra.* This contention is incorrect. In *Kimbell Foods,* the Court held that "federal law governs questions involving the rights of the United States arising under nationwide federal programs," including the treatment of liens stemming from federal lending programs. 440 U.S. at 726. The particular question presented there was whether there should be a judicially created rule of federal common law that "contractual liens arising from certain federal loan programs take precedence over private liens, in the absence of a federal statute setting priorities." *Id.* at 718. In that context, the Court concluded that there was no need to create such a rule and that instead the content of the federal common law generally should be determined by reference to state law.

Plainly, the decision below does not conflict with *Kimbell Foods.* The court of appeals recognized that *Kimbell Foods* was controlling; the question was what is the content of the governing federal law with respect to the distinct

question of the effect of the FmHA's authorization of a sale of collateral. In contrast to the situation in *Kimbell Foods,* federal regulations directly address that question.[3] Petitioner's contention here is that the FmHA's authorization to Stoops operated as a *waiver* of FmHA's security interest; it is surely reasonable that federal law would look to an agency's own regulations in assessing whether the agency's actions were intended to operate as a waiver.[4] In short, the decision below simply represents the application of the general principle of *Kimbell Foods* to a particular question of commercial law; there is no reason for this Court to review the decision.[5]

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[3]The Court in *Kimbell Foods* noted that 7 C.F.R. 1930.17 (1978), the predecessor to 7 C.F.R. 1962.17, required the FmHA to comply with certain state procedural rules in connection with security interests. 440 U.S. at 731. The present regulation does require FmHA to follow state procedures where the proceeds of collateral sales are actually used to acquire new property to be held as collateral. 7 C.F.R. 1962.17(a)(2). Here, however, no new property was ever acquired, and there was no expectation that new property would be acquired. In such circumstances, 7 C.F.R. 1962.18(b) is controlling, and that regulation clearly conditions release of the FmHA's lien on the proper disposition of the proceeds.

[4]Thus, in addition to the presence of federal regulations, this case differs from *Kimbell Foods* in that the question is simply the effect of an action taken by the government itself. State law is not displaced, as it would have been in *Kimbell Foods,* with respect to the setting of lien priority, which would affect private liens as well as government liens. Here, there is no doubt, even under state law, that the government had a valid security interest in the goods; the federal regulations come into play only to assess the import of the government's own conduct in authorizing a sale of collateral, *i.e.,* whether it was intended to operate as a waiver. Looking to federal regulations to determine the significance of a unilateral government action is not a "rejecti[on] [of] well-established commercial rules" (440 U.S. at 740) in the way that creating a special priority rule favoring federal liens would have been.

[5]Petitioner erroneously asserts (Pet. 8-9) that the decision below conflicts with decisions in other circuits. None of the cases cited by petitioner involved a federal regulation. To the contrary, in each of those cases, the government and the other party agreed that the federal rule of decision would be based on state law and the dispute was simply over what the state law provided. Here, by contrast, the question is whether the government waived its security interest by authorizing the sale of collateral, and the court of appeals was quite correct in considering federal regulations that address the sale of collateral and specifically identify the circumstances under which FmHA officials are authorized to waive the agency's security interest.

Petitioner also suggests (Pet. 9-11) that the decision below creates an unfair system that will have deleterious effects on the lending market. There is no basis for such an assertion. First, FmHA did not collect "windfall damages" here (see Pet. 8). It is undisputed that FmHA had a valid security interest in the collateral, and petitioner itself states that the sale in question took place as part of a FmHA liquidation plan (see Pet. 3). It was hardly unjust for FmHA to receive the proceeds of this sale, which amounted to less than half the debt owed.

More generally, it is not apparent why petitioner suggests that the decision below works a fundamental change in commercial practice or portends any future difficulties. Even under state law, it is clear that a security interest continues in collateral after it is sold, unless the sale is authorized by the security holder. Thus, if petitioner does not take steps to determine whether goods it purchases are subject to a security interest, it is at risk even under state law. If it does take such steps and learns that the FmHA holds a security interest, it is on notice that the security interest will continue after sale unless the conditions specified in the regulation are met. In either case, petitioner's ability to protect itself remains the same as under state law.[6]

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[6]Indeed, even in the precise situation presented here, it is not apparent that the result would be different under state law. It is highly questionable that a sale should be considered "authorized" within the meaning of the Missouri statute if the debtor does not satisfy the conditions specified by the creditor in approving the sale. There is a divergence of opinion on the proper treatment under U.C.C. § 9-306(2) (the state

It is therefore respectfully submitted that the petition for a writ of certiorari should be denied.

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provision involved here) of authorizations to sell collateral that are conditioned on certain dispositions of the proceeds. See generally Meyer, "*Crops*" *as Collateral for an Article 9 Security Interest and Related Problems*, 15 U.C.C. L.J. 3, 34-37 (1982). A Missouri intermediate appellate court has indicated that the Missouri statute may be interpreted to resolve such cases in favor of the purchaser, although that case is distinguishable from this one in that the "condition" was not explicit in the security agreement or in a published regulation but simply arose implicitly from a course of dealing. See *Charterbank Butler* v. *Central Cooperatives, Inc.*, 667 S.W. 2d 463 (Mo. Ct. App. 1984). Moreover, the *Charterbank* case did not consider the relevance of Mo. Ann. Stat. § 400.9-307(1) (Vernon 1965), which excepts "a person buying farm products from a person engaged in farming operations" from certain protections against security interests accorded to a "buyer in [the] ordinary course of business." At any rate, this uncertainty about the meaning of the U.C.C. underscores the appropriateness of having a uniform federal rule on this point derived from applicable federal regulations.